CALIFORNIA FILM & TELEVISION TAX CREDIT PROGRAM

EXPENDITURE TRACKING TIPS and RECORD KEEPING

A. GENERAL TRACKING TIPS

1. The cost report must be in U.S. dollars. The costs recorded are to be actual costs with no markups, profit additions or personal expenses.

2. Expenses incurred (costs the production has already paid or accrued) prior to the issuance of the Credit Allocation Letter are not qualified expenditures.

3. Refunds and credit notes received for discounts, rebates, invoicing errors and purchase returns must be credited to the production costs.

4. Proceeds from the sale of props and other production assets must be deducted from the cost presented in the cost report.

    a) Any assets with a purchase price over $10,000 that may have a use after the completion of the production or that may be kept in inventory for future productions will be subject to review in determining tangible personal property value. As a general rule, 50% of the purchase price will be allowed as a qualified expenditure unless appraisal documentation is provided. The appraisal must be performed by an independent qualified 3rd party who customarily provides this type of service. If the asset is destroyed, applicant should maintain documentation as proof for verification by the Certified Public Accountant (CPA).

    b) Any leased or rented items manufactured, assembled, or fabricated to specification with a value over $10,000 shall be treated as a capital lease if it meets any one of the following four conditions: 1. If the term of the lease exceeds 75% of the life of the asset; 2. If there is a transfer of ownership to the lessee at the end of the lease term; 3. If there is an option to purchase the asset for substantially less than the fair market value (“bargain price”) at the end of the lease term; 4. If the present value of the lease payments, discounted at an appropriate discount rate, exceeds 90% of the fair market value of the asset. Any such rental or lease agreement that meets the standards for a capital lease will be considered a purchase and subject to a 50% expense cap for purposes of qualifying for the tax incentive.

5. Office, post production or effects equipment such as computers, hardware and relevant components, copiers, and printers which are purchased for the production will be allowed 1/5 of their purchase price as a qualified expenditure.

6. Completion bond expenditures must reflect any “no claims rebate” received (the amount reported must be net after rebate).

7. Amortization of series costs must be allocated to specific cost categories.

8. All receipts/invoices must be legible; illegible documentation may not be accepted by the CPA.

9. Petty Cash (P.C.) receipts should be numbered, legible, and must not be truncated, with each transaction clearly marked on the front of the P.C. envelope or on a spreadsheet.

10. In-kind services and deferrals are not considered qualified expenditures. Only direct out-of-pocket costs may qualify.

Contingency funds which are spent during the production period should be properly allocated into the specific accounts on the cost reports.

B. SPECIFIC TRACKING TIPS & USEFUL INFORMATION

1. Allocating Wages and Materials in Package Deals

It is customary for some contracted work to package together labor, services, and materials (e.g., prosthetic manufacture, post sound packages, visual effects digital work, set or prop manufacturing). Invoices should indicate what costs of the package are attributable to labor and what costs are attributable to materials or facility costs. In recognizing that it is sometimes difficult to apportion services, below please find some guidelines:

- Post-production facilities which bundle services should break out all labor charges for any sound editorial work.
- Facility stage costs such as ADR recording, Foley recording, and Dubbing stage, digital intermediate creation, and similar services which combine labor and facility/materials may be attributed as non-wage expenses if it is not feasible to separate wages from services/materials.
- Visual Effects companies may use the ratio of 65% labor, 35% materials for all invoices for reporting purposes to the California Film Commission.

2. Verification of In-state Work

Each production must obtain documentation from visual effects, digital effects, and/or title design companies or contractors in order to verify that visual effects, digital effects, and/or title design work was performed in the state. Documentation may be a letter or invoice from the supplier stating that the labor and materials invoiced are attributable to work performed in the state. If a portion of the work was performed out of state by the company or its subcontractors, the statement or invoice must indicate the dollar amount for such work and/or materials. This documentation will be subject to review by the CPA performing the Agreed Upon Procedures.

3. Producer (Hyphenate) Wage Split

If an employee is receiving a Producer (see definition in CFC Guidelines) credit on the project along with a UPM credit, the wages attributable to the UPM account will qualify up to $100,000 (if DGA) or up to the industry standard rate for non-union. Likewise, if a Post Supervisor receives an Associate Producer screen credit, the wages attributable to the Post Supervisor account will qualify up to the industry standard rate. All wages attributable to any individual that receives an on screen producer credit are subject to review.

4. Proof of Usage in State

The use of goods - purchased or rented out of state but used in the state - qualify for the tax credit, as do goods purchased or rented in state. Items purchased in state will need to be prorated if items are also used out of state. For items purchased out of state, the production company must be able to provide proof (e.g. call sheets, production reports, etc,) of use of such items in California to the CPA performing the Agreed Upon Procedures (AUP). This includes any items purchased over the internet and used in the state (see #8 below regarding shipping goods). If proof is not available, cost may be disallowed. For productions where 100% of shooting occurs in California, all items purchased or leased for direct use in the production shall be assumed to be used in-state.

5. Proration For Out of State Work, Goods, and Services

If at any time during the production period the project operates out of state, wages, goods and services must be prorated proportionately to accurately allocate the costs. For example, if an employee who makes $1000/week works 2 days out of the state and 3 days in the state, his or her salary would be prorated and $600 ($200/daily rate x 3 days) would be the employee's qualified wages for that week. If a company is contracted to perform work both inside and outside of the state, their contract amount would need to be prorated proportionately for the percentage of work time expended in and out of California. Corroborating evidence regarding services rendered, amounts owed and paid during a given project phase includes, but is not limited to: (1) fully executed contracts; (2) other written agreements; (3) memorandums of understanding (4) payroll report and (5) cancelled checks. Rented or purchased items such as camera equipment, self-drive cars, production trucks, picture cars and the like must all be prorated if they are used out of state.

6. Proration for Stunt Coordinator or Stunt Riggers/Performers

Stunt Coordinator, stunt riggers or safeties earnings are considered qualified wages when not on camera. The production company must indicate on production reports those days when a stunt coordinator or stunt person performs on camera and tag wages from those days as not applicable.

7. Travel Expense

Airfare is considered a qualified expenditure if air travel originates and concludes in California (intrastate only). Travel allowances to unqualified cast or crew are not considered qualified expenditures; however, if the production company directly pays for a hotel room or corporate housing (no private housing rentals) or intrastate airfare, those expenditures will be considered qualified. Proof of intrastate travel (itemized) will also be required for any travel allowances provided. Aerial photography is qualified provided the helicopter or plane takes off <u>and</u> lands in California.

8. Shipping Goods

The costs to ship items into or out of the state are not qualified expenditures. The costs to ship items intrastate do qualify; however, in both instances, please break out the cost of the item from the shipping costs, so as to properly code these expenses.

9. Related Party Transactions

All related party transactions must be in accordance with an arm's length standard. In determining the true expense of a related party, the standard to be applied in every case is that of a person dealing at arm's length with an unrelated person. A related party transaction meets an arm's length standard if the results of the transaction are consistent with the results that would have been realized if related parties had engaged in the same transaction under the same circumstances with an unrelated party (arm's length result).Whether a transaction produces an arm's length result generally will be determined by reference to the results of comparable transactions under comparable circumstances. The production company should provide the independent CPA with a breakdown of any related party transactions, as they are subject to review.

10. Cut off Date For Tracking Costs

Costs are qualified only until 30 days after the creation of the final elements Documentation which indicates the date of completion of the final elements e.g., digital air master, composite answer print, or digital cinema files, will be required by the CPA performing the Agreed Upon Procedures. This documentation should be a facility invoice evidencing the date the final elements were completed. Only actual expenditures paid up to that date shall be considered qualified expenditures.
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11. Insurance Claims & Budget Thresholds

Any refunds received as a result of a California insurance claim must be deducted from the qualified expenditures total. Any additional costs associated with an insurance claim will not be counted toward the budget threshold criteria (e.g., if an insurance claim causes the production to exceed the $10 mil or $75 million thresholds, the production will not be disqualified or reclassified).

12. Litigation Costs & Budget Thresholds

Any costs associated with litigation including legal fees and settlement costs will not be considered Qualified Expenditures. Any litigation costs that may cause the production to exceed its budget threshold will not be a cause for reclassification or disqualification.

Standard production Legal expenses other than for litigation purposes are considered qualified spend.

13. Expenditure Summary Report

When applying for the Tax Credit Certificate, production companies will be asked to fill out this report, which requests information such as number of man days (total number of persons in specific labor categories working a partial or full day) crew and cast residency, total qualified expenditure on wages, taxable goods and services incurred or used in the state and total payroll taxes paid. Accountants will need to take note of the information needed and "tag" accordingly when inputting the information for cost reporting purposes. When inputting employee data, the payroll service can tag and track some of this information, so it is important for the accountant to discuss this with the paymaster early in the process. Financial information contained in this report requires verification in the Agreed Upon Procedures Report by an independent, California licensed CPA.

14. Employment Diversity Report

This report asks for information on the diversity of the cast and crew. Employees have the option of providing this information on their start paperwork. If the information is provided, ask your payroll service to include this information with the employee's information, so as to be able to provide a report to the production company at the end of the production period. The data from this report will enable the production to complete the Employment Diversity Report

15. Tagging Expenditures

By properly tagging wages and expenditures, accountants will be better able to calculate the production's tax credit allocation, and provide more accurate records for the Agreed Upon Procedures report by the CPA. Below please find some suggestions you may find helpful:

Qualified **E**xpenditure: including all purchases, rentals, travel, shipping in California

Qualified **W**age: including all labor and qualified fringes, whether employee or vendor labor in California

Not **A**pplicable: All non-qualified wages and expenditures

Prior to **A**pplication: All expenditures which were incurred prior to issuance of Credit Allocation Letter

Out of **S**tate (non-qualified) purchases, rentals, travel, shipping, wages and fringes

C. MATERIALS FOR VERIFICATION OF EXPENDITURES

Production companies will need to provide the independent California licensed CPA that will be performing the Agreed Upon Procedures report access to the following materials (including but not limited to):

- Documentation from post production facility verifying completion of final elements.
- List of all visual effects, digital effects, and/or title companies who worked on the production.
- Documentation from all visual effects, title, and/or digital effects companies indicating the total dollar amount of work performed within the state.
- Inventory/Asset list highlighting those items with a purchase price over $10,000 which were not destroyed
- Listing of all related party transactions
- Listing of leased or rented items manufactured, assembled, or fabricated to specification with payment aggregating $10,000 or more
- Copy of Credit Allocation Letter
- Full set of final, signed Production Reports for principal photography and any reshoots/additional photography
- Shooting schedule
- Final crew, cast, and vendor lists
- Final production budget including all non-qualifying expenditures
- Cost Report no later than 30 days after creation of final elements, void of contingencies, Purchase Orders, commitments, etc.
- Detailed Cost Ledger, e.g., Bible
- Payroll register of all cast, crew, and staff paid
- Detailed Trial Balance
- Detailed Ledger of expenditures - digital and hard copy
- Petty cash envelope summaries (front of each petty cash envelope along with original receipts)
- Bank Statements & Reconciliations
- Information to substantiate qualified expenditures, including invoices, purchase orders, receipts, contracts, deal memos, time cards, stop/start forms, etc.